



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0092
916-323-8690 • FAX 916-322-4530
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

BARBARA ALBY
Acting Member
Second District, Sacramento

KRISTINE CAZADD
Interim Executive Director

December 28, 2010

VIA INTERNET

Dear Interested Party:

The Audit Manual (AM) is a guide for the Board of Equalization (BOE) staff in conducting tax and fee audits. It is available to the public and can be accessed from the BOE web page at <http://www.boe.ca.gov/sutax/staxmanuals.htm>.

The attached revisions to AM Chapter 2, *Preparation of Field Audit Reports*, replace the phased out two-digit Business Code with the six-digit North American Industry Classification System (NAICS) codes for use in identifying the taxpayer's primary business activity (section 0206.21), and incorporate procedures for holding a "10-day district office discussion" (section 0207.20). You may contact the BOE at AM.RevisionSuggestions@boe.ca.gov for any comments or suggestions related to these proposed revisions. Your comments or suggestions must be received by BOE no later than **February 28, 2011** in order to be considered by staff. Thank you for your consideration.

Sincerely,

Susanne Buehler, Acting Chief
Tax Policy Division
Sales and Use Tax Department

E-file now, find out how . . . www.boe.ca.gov



Business Code

Sales and Use Tax and Special Taxes accounts are populated with a six-digit North American Industry Classification System (NAICS) code. It is the taxpayer's primary business activity, not what the taxpayer sells, that predominantly determines the taxpayer's NAICS code. The *primary business activity* is the main activity from which the business generates the majority of its revenue and incurs most of its costs. The primary business activity may not be directly related to a taxable activity.

The auditor must verify that the taxpayer's NAICS code accurately identifies the taxpayer's primary business activity by looking up the code in the BOE NAICS Code Generator (Generator). The first two digits of the BOE NAICS code represent the Industry Sector (Sector Code). The Generator provides the Class Description for the Sector Code. The Sector Code and the Class Description must accurately identify the taxpayer's primary business activity.

~~Since the compliance staff depends upon the "class of business" comments to determine the correctness of the business code of record, the auditor will write a concise but adequate description of the taxpayer's business, with emphasis on the major or predominant activity. As a standard procedure, the auditor should verify that the business is coded correctly (Business Taxes Code Book section 203.000).~~

Special comments are required for the following types of business:

- Grocery Store — Beer, wine, liquor, meat, or produce departments (see AM Chapter 9, *Grocers*).
- Restaurant — Beer, wine, liquor, drive-in, and extent and type of take-outs (see AM Chapter 8, *Bars and Restaurants*).
- Construction Contractor — Lump-sum/time and material/cost plus contracts, subcontracts, and over-the-counter sales (see AM Chapter 12, *Construction Contractors*).

When a significant change in the business activity of an active account has occurred before or during the audit period or, if the ~~business was coded~~ NAICS Code is incorrectly ~~ly when the permit was issued~~, the auditor must notify District Compliance as discussed in AM section 0219.03.

NAICS Code

~~On March 6, 2006, the Board implemented the use of codes identified in the North American Industrial Classification System (NAICS) in registering new Sales and Use Tax accounts. The six-digit NAICS codes will be phased in to replace the existing two digit Business Code. When conversion to the NAICS codes is complete, the auditor will verify that the taxpayer's business is coded correctly using the NAICS Code Generator.~~

10-DAY DISTRICT OFFICE DISCUSSION

0207.20

The "10-day" district office discussion is the taxpayer's next step following the exit conference if there are any remaining disputed items. It is initiated by the taxpayer's response to Form BOE-79-A, an audit transmittal letter that allows a taxpayer who does not concur with the audit recommendation "10 days" to respond and arrange for a discussion of the non-concurred items. It is the District Principal Auditor's (DPA) responsibility to hold the 10-day office discussion. However, the DPA may designate someone, other than the exit conference supervisor, to hold the discussion.

A completed Form BOE-836-A, *Report of Office Discussion*, is required for all non-concurred audits, field billing orders, and telephone billings for which a 10-day discussion is held. Form BOE-836-A must document any adjustments to the audit as a result of the 10-day discussion, as well as any items for which the taxpayer is still in disagreement. The DPA must approve and sign Form BOE-836-A in all cases. The completed form must be included in the audit report as outlined on Form BOE-1161, *Audit Arrangement Sheet* (Exhibit 27).

The DPA or designee must attempt to contact the taxpayer by telephone to schedule a district office discussion if the taxpayer fails to respond to Form BOE-79-A or when a telephone billing is needed to protect the statute of limitations of a completed audit. The DPA or designee's efforts to make contact with the taxpayer should be clearly documented in the auditor's "Discussion with Taxpayer" comment in the "General Audit Comments" section of Form BOE-414-A and Form BOE-414-Z.